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IN THE

Supreme Court of the United States

October Term, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

JOINT BRIEF FOR INTERVENING RESPONDENTS THE PENNROAD CORPORATION, LOUIS E. MARRON, JAMES W. HEARN *ET AL.*, IN OPPOSITION

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Preliminary Statement

This brief is submitted by respondents The Pennroad Corporation, Louis E. Marron, James W. Hearn, Paul S. Hearn, William J. Hearn and Eleanor Hearn, members of the public minority stock interest in Arkansas Fuel Oil Corporation (Fuel Oil) in opposition to Cities Service Company's (Cities) petition for a writ of certiorari.

Opinion Below

The opinion of the Court of Appeals, dated July 15, 1957, is officially reported at 247 F. 2d 646 (3a-18a). The findings and opinion of the Securities and Exchange Com

mission (Commission), dated August 31, 1956, have not been officially reported, but are set forth in Holding Company Act Release No. 13254 (19a-47a).

Jurisdiction

The judgment of the Court of Appeals was entered August 14, 1957 (1a-2a). Petitioner invokes the jurisdiction of this Court under Section 24 of the Public Utility Holding Company Act of 1935, 15 U. S. C. 79x(a) and under 28 U. S. C. 1254(1).

Statute Involved

The statute involved is Section 3(a) and Section 11 of the Public Utility Holding Company Act of 1935 (Act).

Question Presented

Where, after extensive hearings, the Commission finds,

(1) that Fuel Oil, a registered holding company and a subsidiary of Cities, also a registered holding company, is an integral and indistinguishable part of the integrated Cities system, so that all decisions are made for Fuel Oil at the Cities level,

(2) that the public minority stockholders of Fuel Oil, who can only vote at the departmental and not the Cities level, are in fact disenfranchised, and

(3) that the system level determinations by Cities involve conflicts of interest between the Cities system and Fuel Oil to the detriment of the public minority stockholders of Fuel Oil,

is it within the power of the Commission to find that there is present an inequitable distribution of voting power within the meaning and intent of Section 11(b)(2) of the Act, and therefore deny Cities' application for an exemp-

tion from the provisions of the Act that would terminate the Commission's power to require correction of the statutory violation?

Statement

The judgment sought to be reviewed affirmed an order of the Commission denying Cities' application for an exemption from the provisions of the Act. At the direction of the Commission the proceedings to consider that application were consolidated with then pending proceedings under Section 11(b)(2) and Section 11(c) of the Act affecting Cities and Fuel Oil (21a).

The reason for the consolidation was that in the prior proceedings under Sections 11(b)(2) and 11(c) the Commission had *conditionally* approved a plan filed by Cities and Fuel Oil, designed to effect compliance by Fuel Oil with the provisions of the Act. The condition was occasioned by the finding by the Commission that under the plan there would continue to be a public minority stock interest in Fuel Oil and that its existence presented a problem which might require corrective action (58a). The Commission stated that it would consider that problem at a later date and therefore "subject to the reservations noted" approved the plan as an appropriate means for achieving the results required by Section 11(b) (59a). In its order approving the plan, therefore, the Commission expressly reserved jurisdiction with respect to the resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil and to entertain such further proceedings and to enter such further orders as might be necessary or appropriate to effectuate the provisions of Section 11(b) of the Act (68a, 69a).

Since the Commission expressly stated that by reason of the public minority it could only conditionally approve the Plan as an appropriate means for achieving the results required by Section 11(b) (59a) and reserved jurisdiction to enter further orders under Section 11(b) (68a), obviously there is no merit in Cities' contention that the Commission had not indicated that the public minority interest might present an 11(b)(2) problem (27a-30a).

If Cities' application for an exemption were granted, the Commission would no longer have the power to deal with the problems posed by the public minority pursuant to Section 11(b) of the Act and its reservation of jurisdiction would have been rendered futile. Accordingly the Commission directed a consolidation of the proceedings arising from Cities' exemption application with the 11(b)(2) and 11(c) proceedings so that the application for exemption could be considered in relation to the unresolved 11(b)(2) and 11(c) proceedings.

Thereafter, after extensive hearings in the consolidated proceedings, the Commission found, factually, that the situation of Fuel Oil in the context of the Cities system was such that the public minority stock interest in Fuel Oil was effectively disenfranchised. The Commission held that, in consequence, there was an inequitable distribution of voting power within the meaning of Section 11(b)(2) of the Act which precluded the granting of an exemption and for that reason entered an order denying Cities' application.

Upon petition to review to the Court of Appeals for the Second Circuit, that Court held that there was "ample support in fact and common sense for the conclusions of the Commission that there were inherent conflicts of interest and the *de facto* disenfranchisement of the minority interest. On this record the Commission was justified in refusing to grant exemption to Cities until Fuel Oil eliminated the minority interest" (18a).

ARGUMENT

Summary of Argument

(1) The question posed in the petition is not, in fact, presented by this record.

(2) The inequitable distribution of voting power, here found to be present, constitutes a violation of Section 11(b)(2) of the Act that empowers the Commission to require remedial action.

POINT I

The question stated in the petition is not presented by the record.

Cities has abandoned the legal contention it advanced in the Court of Appeals, an asserted lack of jurisdiction of the Commission over Cities and Fuel Oil because both companies had theretofore disposed of their domestic utility properties. On this legal issue the Court below ruled against Cities, expressly concurring with a prior determination of the Court of Appeals for the Third Circuit in *In re United Corporation*, 232 F. 2d 601, which this Court declined to review (352 U. S. 839).

Instead, Cities now asks this Court to issue a writ to review a factual conclusion of the Commission, a conclusion for which the Court of Appeals found there was "ample support in fact and common sense" (18a). The Commission found that Fuel Oil is so intimately tied to the Cities System by a multiplicity of affiliations and intra-system transactions that, operationwise, it has been assimilated into and, for all practical purposes, is a part of the Cities System (35a), so that the public minority stockholders of Fuel Oil, who have no vote in selecting the system managers, were effectively disenfranchised (46a), and finally, the Commission found that the system decisions, which determine the operations of Fuel Oil, continuously involve a conflict of interest between the Cities system on the one hand and Fuel Oil on the other, at least in so far as its impact on the minority stockholders of Fuel Oil is concerned (45a).

Obviously, this Court is not concerned with reviewing such factual conclusions of an administrative agency (*Securities and Exchange Com.* v. *Chenery Corp.*, 332 U. S. 194, 204, 208, 209; *Securities and Exchange Com.* v. *Central-Ill. Sec. Corp.*, 338 U. S. 96, 127).

In order, however, to induce this Court to issue a writ, Cities attempts to pose the question presented as though it

were one of law, as though the Commission had held that in every case, where there are any business relations between a subsidiary of a registered holding company and another subsidiary in which there is a public minority interest, that, in and of itself, constitutes a violation of Section 11(b)(2) of the Act (pet. p. 2).

Upon this false premise Cities urges that the question is one of importance since there are many public utility holding companies that have subsidiaries with a public minority interest (pet. p. 19) and that the Commission's decision in the instant case conflicts with its ruling in many prior instances in which it permitted the continuance of a public minority interest.

That the question posed is not here presented is evidenced by the findings and opinion of the Commission and the opinion of the Court of Appeals. There was no ruling that whenever there are any business relations between two subsidiaries of a registered holding company, in one of which there is a public minority interest, there is present a violation of Section 11(b)(2). The holding of the Commission goes no further than to say that when it is shown that a subsidiary in which there is a public minority interest is so interwoven into a system operation that except on paper there is no such thing as the subsidiary enterprise, the public that owns a minority interest in this indistinguishable segment of an integrated system is, in fact, disenfranchised, and when a review of the dealings between the parent and subsidiary evidences conflicts between the interests of the system operation and those of the subsidiary to the detriment of the public minority stockholders in the subsidiary, there is present an inequitable distribution of voting power in violation of Section 11(b)(2) of the Act. That such, and such only, was the determination of the Commission, that it stated no blanket legal principle, is evidenced not only by the findings and opinion of the Com-

mission and the opinion of the Court of Appeals but by the fact that some 2,000 pages of testimony were required to develop the facts of this situation and of this situation alone.

The Commission, in 1952, when it approved the plan of reorganization submitted by Cities and Fuel Oil subject to the express reservation that it would subsequently inquire into the 11(b) implications of the presence of a public minority interest in Fuel Oil (58a, 59a), was then well aware that there was a public minority in a subsidiary of Cities and that this subsidiary had some intercorporate relations with other subsidiaries of Cities. Had this alone sufficed for a determination that there was a violation of Section 11(b)(2), the Commission would have so declared. What it did, however, was to hold merely that the minority interest presented a problem "which may require corrective action" (58a).

The Commission thereafter required hearings to be held and only after consequential disclosure that there was not only a minority interest in the subsidiary but also a complete assimilation of the subsidiary into the system, accompanied by conflicting interests and resulting in effective disenfranchisement, did it conclude that there was here present an inequitable distribution of voting power in violation of Section 11(b)(2).

Indeed, the cases in which the Commission permitted the continuance of a public minority interest establish, not that the Commission has reversed itself, as Cities would contend, but that as the Commission stated, "whether the presence of a minority interest involves a detriment which the statute seeks to prevent must, of course, be resolved on the facts in each case" (34a, 35a). Since the issue is a factual one, we find that, as in some instances the Commission has permitted the continued existence of a public minority, in many other cases it has held that the subsidiary is so integral a part of the integrated system operation that

there is effective disenfranchisement within the prohibition of Section 11(b)(2).[2]

We submit that the factual conclusion arrived at by the Commission, on the basis of an extensive record and as a result of its expert experience in the administration of the Act, a conclusion in which the Court of Appeals concurred, does not require review by this Court.

POINT II

The inequitable distribution of voting power here found to be present constitutes a violation of Section 11(b)(2) of the Act that empowers the Commission to require remedial action.

In the informed judgment of the Commission, the public minority in Fuel Oil is effectively disenfranchised; it has, in reality, no vote. This factual conclusion was affirmed by the Court of Appeals. Necessarily, therefore, since some of the security-holders in the holding company system are disenfranchised, there is an inequitable distribution of voting power. Cities urges, however, and would have this Court issue a writ to consider its contention, that the Commission is powerless to remedy the condition for the reason that the inequitable distribution of voting power here present does not arise by reason of (1) the corporate structure or (2) the continued existence of Fuel Oil, and only an inequitable distribution of voting

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[2] *Southern Natural Gas Company et al.*, 34 S. E. C. 718, 726-727 (1953); *Alabama Power Company et al.*, 34 S. E. C. 219, 224-225 (1952); *United Gas Improvement Company et al.*, 33 S. E. C. 729, 738 (1952); *American Gas and Electric Company*, 32 S. E. C. 130, 141-142 (1950); *Southern Company et al.*, 31 S. E. C. 821, 834 (1950); *Sioux City Gas and Electric Company et al.*, 30 S. E. C. 5, 14-15 (1949); *Electric Power & Light Corporation et al.*, 29 S. E. C. 52, 65 (1949). See also *Georgia Power and Light Company et al.*, 18 S. E. C. 89, 103-104 (1945).

power, however improper, produced by those causes alone, may be corrected by the Commission (pet. pp. 9-12).

We submit that the statutory power of the Commission is not to be so restricted. Congress has charged it with "the duty * * * to examine * * * the relationships among the companies in the holding-company system of every such company and the character of the interests thereof * * * to determine the extent to which * * * voting power [may be] fairly and equitably distributed among the holders of securities thereof * * * " (Sec. 11(a)).

But again Cities is posing problems that are not presented by the record. Even assuming that the Commission's power to correct an inequitable distribution of voting power is limited to those situations where such an inequity is caused by the corporate structure or continued existence of any company, we find that cause present here on both counts. The corporate structure of the holding company system on a consolidated basis includes and reflects the presence of a public minority interest in Fuel Oil. It is that portion of the corporate structure that occasions the inequitable distribution of voting power. It is within the power of the Commission, under the express language of Section 11(b)(2), however restricted a meaning be given to it, to correct that corporate structure in order to ensure an equitable distribution of voting power.[3]

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[3] Cities' contention respecting restrictions on the Commission's power by reason of the language of the third sentence of Section 11(b)(2) is wholly irrelevant. By its express terms the restriction in no event applies when the purpose is to "fairly and equitably distribute voting power among the security holders of such company". Here the purpose is to effect a fair and equitable distribution among the security holders of Fuel Oil. Moreover the limitation is confined to operating companies and Fuel Oil is a registered holding company. Cities' point that Fuel Oil is a registered holding company but not a holding company, and therefore the Commission has only a restricted jurisdiction over it, is an attempt at semantic gymnastics that does not even have a specious appeal.

Moreover, this case clearly comes within the second stated cause. The statute requires the Commission to see to it that the "continued existence of any company *in the holding company system*" does not unfairly or inequitably distribute voting power among securityholders of such holding company system. It is pointless for Cities to seek to avoid the impact of this provision with the statement that neither the Commission nor the Court of Appeals held that the "continued existence" of Fuel Oil results in "an inequitable distribution of voting power" (pet. p. 9). The whole thrust of the Commission's findings and opinion is that the continued existence of Fuel Oil in the holding company system, as Fuel Oil is presently constituted, results in an inequitable distribution of voting power. Thus it is the directive of the Commission that Fuel Oil, as it is presently constituted, cannot continue to exist in the holding company system. And this divorcement is to be effected either through Cities' disposing of its majority interest in Fuel Oil, at which point Fuel Oil would no longer be a part of the system; or, alternatively, through Cities acquiring the minority interest, at which point, while Fuel Oil would remain part of the system, it would not continue its existence in the system, as it is presently constituted (46a).

So we find both the statutory evil, an inequitable distribution of voting power, and the designated statutory cause of that evil, the continued existence, as it is presently constituted, of Fuel Oil in the holding-company system.

Conclusion

The Commission, affirmed by the Court of Appeals, has found as a fact that in the instant situation there is an inequitable distribution of voting power within the prohibition of Section 11(b)(2) of the Act. The questions posed in the petition are not presented by the record and such issues as are presented do not warrant review by this Court.

The intervening respondents respectfully pray that the petition for a writ of certiorari be denied.

Dated: December 6, 1957.

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